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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

CHARLES R. WHITWORTH AND
ESTATE OF SARAH M. WHITWORTH,
CHARLES R. WHITWORTH, EXECUTOR,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

SPAULDING GLASS,
135 South LaSalle Street,
Chicago 3, Illinois,
Attorney for Petitioners.

TWENTIETH CENTURY PRESS, INC., CHICAGO

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	3
Reasons for granting the writ	7
Conclusion	17
Appendix	18

CITATIONS

Cases:

Bull v. United States, 295 U.S. 247	16, 17
Burnet v. Leininger, 285 U.S. 136	8, 9, 15
Charles F. Coates v. Commissioner, 7 T.C. 125	11, 13, 17
Commissioner v. Sunnem, 333 U.S. 591	8
Douglas v. Willcuts, 296 U.S. 1	8
Carol F. Hall, et al., 19 T.C. 57	1, 6, 11
Harrison v. Schaffner, 312 U.S. 579	8
Helvering v. Clifford, 309 U.S. 331	8
Helvering v. Eubank, 311 U.S. 122	8
Helvering v. Horst, 311 U.S. 112	8
Sidney Hess, 12 T.C. 773	11, 17
Lucas v. Earl, 281 U.S. 111	8, 15
Courtland N. Smith, CCH, Dec. 17,989(M), 9 TCM 1084 (1950)	17

PAGE

Statutes:

Internal Revenue Code:

Sec. 22(a) 8
Sec. 22(b)(3) 10, 18
Sec. 113 18
Sec. 117 ..... 19, 20
Sec. 181 20
Sec. 182 21
Sec. 183 ..... 21, 22
Sec. 184 ..... 22, 23
Sec. 186 23
Sec. 187 23
Sec. 188 24
Sec. 189 24
Sec. 190 24
Sec. 3797 ..... 24, 25

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COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Petitioner prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Seventh Circuit entered in this case on June 12, 1953.

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (Tr. 121-133) are not officially reported. The companion case of *Carol F. Hall, et al.*, is reported at 19 T. C. No. 57. The opinion of the Court of Appeals (Tr. 141-146) is reported at 204 F. 2d 779.

JURISDICTION

The judgment of the Court of Appeals was entered on June 12, 1953 (Tr. 147). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254(1).

QUESTIONS PRESENTED

Petitioner, Charles R. Whitworth, was a member of a partnership engaged in the practice of public accountancy. Each member of the partnership was legally bound under the terms of an agreement which contained a provision for retirement of the partners at the age of 65, but specifically had no application to any partner who retired or withdrew at any other age or for any other cause. Petitioner withdrew from the firm at the age of 59 and was not entitled to any retirement payment. The firm voluntarily paid petitioner the sum of $60,000 ratably over a five-year period. $12,000 each for 1945 and 1947 is in issue. Petitioner performed no services for the firm during these years and had been paid in full for past services, at the time he withdrew from the firm on May 1, 1942. During 1945 and 1947 the firm income was earned and belonged to the continuing partners.

The questions presented are as follows:

1. Whether petitioner received any ordinary income taxable to him as a result of the transaction whereby he received $60,000 and $12,000 in each of the years, 1945 and 1947, or:

2. Whether petitioner is to be taxed on such amounts as ordinary income, as the Tax Court held and the Court of Appeals affirmed, or whether he is to be taxed with gain from the sale of a capital asset, his partnership interest.

STATUTE INVOLVED

The applicable provisions of the statute involved are set forth in Appendix, *infra*, pp. 18-25.

STATEMENT

The undisputed, pertinent facts of the case may be summarized as follows:

Charles R. Whitworth's association with Touche, Niven & Co., an internationally known public accounting firm dates back to 1913, in which year he entered the firm's employ. (Tr. 26.) He became a partner in the firm on January 1, 1919, with a capital contribution of $12,500, and, in a written Partnership Agreement entered into on March 1, 1922 was designated a Senior Partner. (Tr. 26.) The 1922 agreement was superseded as of October 1, 1936 by a new Partnership Agreement naming seventeen partners, five of whom, including Whitworth, were designated as Administrative partners. (Tr. 26-27, 36.) Mr. Whitworth continued as a member of the firm until May 1, 1942 when he resigned. On April 30, 1942, capital, an income producing factor, included $263,600.19 salary cost of work in progress, unconverted to billing, or accounts receivable, which then was $72,195.74. (Tr. 112.)

The question of Whitworth's complete withdrawal from the firm was the subject of a letter written by Whitworth to Messrs. Touche, Niven & Co. under date of October 27, 1939. (Tr. 63.) In this letter, Mr. Whitworth referred to a previous expressed desire to retire from the firm on reaching the age of 60 which would occur on October 12, 1943, and gave notice of his intention to assume a less active status in the partnership in the meantime, and that his retirement should be effective as of September 30, 1943. Mr. Whitworth's proposed withdrawal from the firm was accepted by endorsement of the letter by Touche, Niven & Co. (Tr. 63-64.)

Although it had been contemplated that Whitworth would retire from the firm as of September 30, 1943, he actually

withdrew from the partnership on May 1, 1942, at which time he was only 59 years of age. In a letter written by the firm to Mr. Whitworth under date of June 4, 1942, it was explained that the understanding as to the payments to be made him, as expressed in his earlier letter, would not be changed by virtue of his retirement at a date earlier than had been anticipated. The letter continued: "The theory of our arrangement with you is, as you know, that we are trying to make your retirement allowance equal to a three years' payment at the rate of $20,000 per year, provided your income from the firm for three years ending September 30, 1943, averages that much, and we will adhere to that understanding." (Tr. 64-66.) This letter coupled with that of Clowes to Whitworth, dated October 7, 1943, saying in part, "This, then will mean a remittance of $3,000 on or about December 31st, March 31st, June 30th and September 30th in each of our next five fiscal years beginning with December 31, 1943," fixed the sum of $60,000 that was to be paid Whitworth. (Tr. 68.) The firm also wrote Whitworth on November 27, 1942, confirming his withdrawal as a partner as of May 1, 1942, but stating that the financial arrangements agreed upon in Mr. Whitworth's letter of October 27, 1939, would nevertheless remain unchanged. As expressed in the letter of November 27, 1942, Whitworth was to receive an amount equivalent to his salary and interest in the firm's distributable profits as though he had remained a member of the firm until September 30, 1943, after which time, notwithstanding the fact that he would not then have attained the age of 65 years, he was to be paid a sum according to a formula adopted from Section 2 of Article XI of the Partnership Agreement. (Tr. 66-68.) Whitworth's approval of the arrangement was noted by his endorsement of the letter.

Pursuant to the provisions of these letters, Whitworth

was paid, for the year ending September 30, 1942, $20,405.17, and for the year ending September 30, 1943, $20,000, although he performed no services for the firm subsequent to April 30, 1942. Mr. Niven, the head of the firm, characterized these payments to Whitworth as "voluntary" on the part of the firm. (Tr. 99.) These amounts were reported as partners' distributable income in the firm's information return filed in those years. (Tr. 131.) Whitworth was also paid the credit balance of $12,500 in his capital account, which had been paid in by him on his admission to the firm, and the sum of $3,978.36, which represented his share of the cash surrender value of a policy on the life of Mr. Niven. Neither of these payments was deducted by the firm in computing partners' distributable income. (Tr. 131.) Further in accordance with the provisions of these letters, Touche, Niven & Co. paid Mr. Whitworth, via quarter-annual installments of $3,000 each, the sum of $12,000 in each of the firm's fiscal years ending September 30th in 1944, 1945, 1946, 1947 and 1948. (Tr. 131-132.) With reference to these payments, Mr. Niven testified that the firm was under absolutely no obligation, under the Partnership Agreement, to make such payments to Mr. Whitworth. (Tr. 97-99.) He stated that the firm had made the payments voluntarily, according to the provisions of the letters exchanged between the firm and Whitworth (Tr. 99), and that Section 2, Article XI payments were to be made only to those partners who reached age 65 or earlier died. (Tr. 78, 80.) Each year the firm advised Whitworth that it reported the annual $12,000 payment to him as his proportion of the income of the firm for the year, although he had resigned as a partner as of May 1, 1942. (Tr. 115-119.)

In their income tax return for the year 1945, Whitworth and his wife reported the $12,000 paid by the firm to him,

as ordinary income, but in their return for 1947 the $12,000 paid him in that year was treated as capital gain, and an amended return for the taxable year 1945 was filed and a claim for refund made, based on the contention that the annual $12,000 payments to Whitworth, represented the purchase price paid him for the sale of his partnership interest in Touche, Niven & Co. (Tr. 131-132.) The claims for refund were rejected by the Commissioner, and deficiencies determined against Whitworth and his wife for the taxable years 1945 and 1947, resulting in the Whitworths' filing of a petition for redetermination of tax by the Tax Court.

The case before the Tax Court was consolidated for trial with the cases of *Francis J. Clowes,* who had ceased to be a partner of Touche, Niven & Co. upon reaching the age of 65, and *Carol F. Hall,* one of the continuing partners in the firm. The cases so consolidated were heard in New York City on November 5 and 6, 1951. The Tax Court's decision in the *Hall* case contains findings related to this case. 19 T. C. No. 57.

In its Memorandum Findings of Fact and Opinion entered December 12, 1952, the Tax Court held that the amounts paid Whitworth in 1945 and 1947 by Touche, Niven & Co. constituted ordinary income and not capital gain in Whitworth's hands and that respondent Commissioner had not erred in determining deficiencies on that basis. (Tr. 121-133.) The Court, in its very brief opinion, stated that its conclusion followed from its decision in the companion case of *Carol F. Hall, et al.,* 19 T. C. No. 57, in which it held that the payments made in 1947 by Touche, Niven & Co. to Whitworth, to Francis J. Clowes and to the Estate of Victor H. Stempf, did not represent a part of the

purchase price of the interests of the former partners so named, but were distributions of firm income to them, made pursuant to Section 2 of Article XI of the 1936 Partnership Agreement and, accordingly, controlled by that Section's tax-intent clause, which states that "The payment under this Section 2 is intended as a distribution of income to the retiring partner or the estate of a deceased partner for a limited period subsequent to his retirement or death." (Tr. 49.)

The Court of Appeals affirmed the decision of the Tax Court, in part, holding that "If all the parties concerned were willing to bring taxpayer under a special retirement plan, harmonious on the whole, to the stated provisions of Section 2 of Article XI, no good reason appears why they should not so contract," and that in fact it made little difference whether the payments aggregating $60,000 were being made by a special agreement under Section 2 of Article XI of the Partnership Agreement or independently of it. (Tr. 145.)

REASONS FOR GRANTING THE WRIT:

I.

Payments received under a gratuitous arrangement are not taxable income to a recipient, and the decision below is in conflict with applicable decisions of this Court.

II.

A serious loss of tax revenue will result if the decision of the Court of Appeals is permitted to stand.

I.

PAYMENTS RECEIVED UNDER A GRATUITOUS ARRANGEMENT ARE NOT TAXABLE INCOME TO A RECIPIENT, AND THE DECISION BELOW IS IN CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT

The decision below, of necessity, rejects the principle that, for purposes of taxation, income cannot be disassociated from the source which created it. The decisions of the Court are uniform in holding that the person whose services or property create income cannot be relieved from taxation by an anticipatory transfer of the right to the income to another. *Lucas* v. *Earl,* 281 U. S. 111; *Douglas* v. *Willcuts,* 296 U. S. 1; *Helvering* v. *Clifford,* 309 U. S. 331; *Helvering* v. *Eubank,* 311 U. S. 122; *Helvering* v. *Horst,* 311 U. S. 112; *Harrison* v. *Schaffner,* 312 U. S. 579; *Commissioner* v. *Sunnem,* 333 U. S. 591.

The tax on partnership profits cannot be escaped by anticipatory arrangements by which the fruits are attributed to a different tree from that on which they grew. *Burnet* v. *Leininger* (1932), 285 U. S. 136, rehearing denied, reversing 51 F. 2d 7, and, in effect, affirming 19 BTA 621. This Court thus applied the principle of *Lucas* v. *Earl, supra.* It is well settled under Section 22(a) of the Internal Revenue Code (Appendix, infra, p. 18) that income is taxable to one who is the source of the income and the one who controls it, *Lucas* v. *Earl, supra; Harrison* v. *Schaffner, supra.* In the last cited case, at page 502, it was emphasized that "One vested with the right to receive income did not escape the tax by any kind of anticipatory agreement, however skillfully devised, by which he procures payment of it to another, since, by exercise of his power to command the income, he enjoys the benefit of the income on which the

tax is laid." Accordingly, the income of the partnership in question for the years 1945 and 1947 would, under the Partnership Agreement, be properly taxable to the continuing partners as ordinary income, because they alone had a vested right to it. Not Whitworth, but the continuing partners, earned and exercised control over firm income; the latter are therefore properly taxable on the whole of that income, despite their equitable assignment of $60,000 in total and $12,000 each for 1945 and 1947. He had no more legal right to the firm income for 1945 and 1947 than the wife in *Leininger, supra.* The fact that he received such sums is no different in effect than the receipt by the wife of one-half the profits earned by Leininger.

Section 2 of Article XI of the Partnership Agreement of October 1, 1936 specifically limited the provisions for the payment to be made under that section to cases of partners reaching age 65, or earlier dying. The testimony of John B. Niven corroborates this statement. (Tr. 78, 80, 97-100.)

Only Section 2, above mentioned, contained the provision that, "The payment under this section 2 is intended as a distribution of income to the retiring partner or the estate of a deceased partner for a limited period subsequent to his retirement or death." This is referred to in the record as the "tax-intent" clause.

Section 3 of Article XI of the contract gave the Administrative partners authority to pay out any sum in advisable installments to any partner retiring or withdrawing from the firm before reaching age 65 or for any other reason.

Musgrave, Kaufman, and Edwin H. Wagner, Jr. each were voluntarily paid amounts as "an act of grace" according to Mr. Niven, the titular head of the firm, upon resigning before reaching age 65. (Tr. 100, 101.)

Why was it then that Mr. Whitworth, occupying a similar position to these others, not having reached age 65, and desiring to sever his connection with the firm, was subject to a different arrangement? The answer lies in the fact that the partners sought to make a Section 2, Article XI contract out of a Section 3, Article XI situation, in order to insure for themselves, as the continuing partners, a deduction from income earned by them, by application of the "tax-intent" clause of Section 2, accurately described as a tax avoidance clause by Mr. Clowes who drafted it. (Tr. 74-76.) That the Whitworth payments were more of the "act of grace" type referred to by Mr. Niven in his testimony, is borne out by what Niven also said with reference to these payments; recognizing Whitworth to have been but age 59, he said, "Then he was entitled to nothing." (Tr. 97.) Mr. Niven sarcastically cast doubt that Mr. Whitworth even earned his share of firm income as a participant up to September 30, 1941, when he was still a partner. (Tr. 98.) Referring to Whitworth's share of profits for this last stated period, Niven testified, "After that was paid, we absolutely owed him nothing. I mean to say under our contract." (Tr. 97-98.) The payments to Whitworth for the partnership fiscal years ended September 30, 1942 and 1943 were voluntary payments, made without consideration, and that for the 1943 fiscal year could be called a "gift" according to Mr. Niven. (Tr. 99.) The payments totalling $60,000 were in that category, the contract being void for lack of mutuality. I.R.C. Section 22 (b)(3), (Appendix, infra, p. 18).

Obviously, a payment to a retiring or withdrawing partner under Section 3 of Article XI would not free the continuing partners from tax on the earnings of the partnership from which such amounts would be paid. Mr. Whitworth, at age 59, stood in the exact position of Mus-

grave and one similar to Kaufman and Wagner in that he desired to retire before age 65. According to the testimony of Clowes, Whitworth had suffered "something in the nature of a nervous breakdown." (R. 207.) Musgrave was given some stipend to tide him over a transition period. (Tr. 100.) The liability to pay any amounts under Section 3 of Article XI was purely discretionary with the Administrative partners and was not a definite contract liability of the firm. Any payment made thereunder would necessarily be "an act of grace," and tax-free to recipients. This provision of the contract could not be classified as part of a mutual insurance plan. *Coates* v. *Commissioner*, 7 T. C. 125 (1946); *Sidney Hess*, 12 T. C. 773.

The evidence before the Court establishes beyond question that the payments to Whitworth were not made pursuant to Section 2 of Article XI of the Partnership Agreement, and the Court of Appeals so agreed. (Tr. 145.) By its own terms, Section 2 being limited in application to partners reaching age 65 or earlier dying, it did not apply to the contract with Whitworth or payments to him, as on May 1, 1942, the effective date of his withdrawal, he was but 59 years of age. The Tax Court, in its opinion in the *Hall* case, took note of this contention on Whitworth's behalf, but concluded that "his correspondence with the firm effecting the agreement under which the payments were made to him contradicts this assertion." The Court then proceeded to quote from the letters of October 27, 1939 and November 27, 1942. (Tr. 63-64, 66-68.) That the Tax Court erred in relying on these references to Section 2 in the letters exchanged between Whitworth and the firm, to support its conclusions that Section 2 was applicable to the Whitworth payments, can be clearly demonstrated by an analysis of those letters in conjunction with the amendatory clause contained in the Partnership Agreement.

Article XX of the Partnership Agreement provided that the agreement could be amended only by means of a supplemental agreement signed by three-fourths in interest of all the partners and filed at the firm's principal office in New York City. It thus becomes quite obvious that the references to Section 2 of Article XI contained in the letters exchanged between Whitworth and the Administrative partners, could not have had the effect of amending the Partnership Agreement so as to make Section 2 applicable to a partner withdrawing from the firm before attaining the age of 65. There was no such amendment of Section 2 to eliminate the age 65 limitation, and the exchange of letters could not operate as a waiver of this mandatory provision. Nor can the provisions of Section 2 be said to have been incorporated by reference into an agreement which the Administrative partners were empowered to enter into under Section 3 of Article XI. This section did confer on the Administrative partners very broad authority to pay such sum of money they deemed advisable in the case of a partner withdrawing from the firm before reaching retirement age, and under its provisions, the Administrative partners did have the authority to incorporate into their agreement with Whitworth the tax-intent clause or any other of the express provisions of Section 2 of Article XI, but this they did not do and could not have done merely by reference to the provisions of Section 2 generally.

The contract correspondence contains not one reference to the tax-intent clause as such, and the general references to Section 2 cannot be given any effect via the doctrine of incorporation by reference, for if Section 2 were to be so incorporated into the agreement with Whitworth, the result would be no agreement at all, inasmuch as one of the provisions of Section 2, which would necessarily be incorporated by reference to Section 2 generally, limits its ap-

plicability to partners retiring after reaching age 65, whereas Whitworth was only 59 at the time of his withdrawal.

On the foregoing theory presented on appeal, it must be concluded that the payments to Whitworth were made to him gratuitously, according to the letters referred to, regardless of their implication. The continuing partners of Touche, Niven & Co., should not be permitted to shift the tax burden to Whitworth on their earnings for 1945 and 1947, the taxable years here involved.

II.

A SERIOUS LOSS OF TAX REVENUE WILL RESULT IF THE DECISION OF THE COURT OF APPEALS IS PERMITTED TO STAND.

The Tax Court held that the payments to Whitworth were taxable to him as ordinary income because he agreed that his retirement should be effective under the provisions of Section 2, Article XI of the Partnership Contract, and that he was entitled to receive the retirement payments provided thereby. It relied on the case of *Charles Coates* 7 T. C. 125, saying, "There are factual differences, but we do not think them significant." In the *Coates* case the Tax Court regarded the provision for participation of an estate of a deceased partner in the net earnings of the partnership for a subsequent period of five years at the inception of the partnership contract as evidence of an intention by the partners that such participation was not to be the consideration paid by the partners for the capital interest of a deceased partner upon dissolution and liquidation of the partnership. Rather the parties intended the arrangement to be in the nature of a mutual insurance plan, the disadvantage of which each partner was willing to ac-

cept in consideration of a similar commitment for his benefit on the part of all other partners, which imparted a present consideration to the contract.

The Court of Appeals said:

> "We think the record establishes without question that the payments aggregating $60,000 were made pursuant to an independent agreement between taxpayer and the other members of the co-partnership and while all parties, including taxpayer, apparently proceeded on the theory that they were being made by special agreement under Section 2 of Article XI, it in fact makes little difference whether they were so made independently of Section 2 of Article XI, although under the formulae therein enunciated. If all parties concerned were willing to bring taxpayer under a special retirement plan here, harmonious on the whole, to the stated provisions of Section 2 of Article XI, no good reason appears why they should not so contract. The arrangements were fully compatible with the very generous and apparently wholesome attitude of the co-partnership in desiring to permit taxpayer on retirement to share for a limited time in the income of the firm, regardless of his further contribution of services."

And further:

> "The fact that taxpayer received from the firm more than he had a right to demand is no indication that the sums received were in payment for any interest in the firm or that they became upon receipt an enhancement in his capital assets as distinguished from income."

From its reasoning it is evident that the Court of Appeals recognized Mr. Whitworth had no right to demand and receive the retirement payments provided for under Section 2 of Article XI of the Partnership Agreement. It

was not realized by the Court that it does make a great deal of difference whether petitioner qualified under Section 2 of Article XI of the firm contract; if the agreement made was independent of such section, the contract would be void for lack of mutuality absent any present consideration based on either the sale of a partnership interest, or, the disadvantage each partner was willing to accept in consideration of a similar commitment for his benefit on the part of all other partners. It is obvious that the independent contract consideration in the case at bar could not have been linked to a mutual insurance plan. The difference between the conclusions of the Tax Court and the Court of Appeals lies in the failure of the Court of Appeals to recognize that a mutual insurance plan, which the partners of Touche, Niven & Co. intended to be given effect by the contract with Whitworth must rest upon the present consideration given by each partner *at the time of formation of the partnership.* The Court of Appeals totally missed this point in concluding that it made little difference whether or not the contract between the parties was independent of Section 2 of Article XI. That an arrangement was not effected under Section 2 of Article XI is amply demonstrated in the preceding section hereof. The Court below agreed.

It matters not whether the arrangement was generous and wholesome. An equitable assignment to the wife in *Leininger, supra,* may have been a generous act on the part of the husband who earned the money, but this Court regarded such assignment to be ineffective for tax purposes. *Cf., Lucas* v. *Earl, supra.*

If there was any legal consideration for the contract between the firm and Mr. Whitworth, expressed by the documents of record (Exs. C-3, D-4, E-5, F-6; Tr. 63-67), this consideration was Mr. Whitworth's partnership inter-

est, which was surrendered as a result of the transaction. He left more capital in the firm than the $12,500 returned to him. The transaction thus amounted to the sale of his interest. (See *Bull* v. *United States*. 295 U. S. 247.) Mr. Whitworth had a right to remain in the firm until the retirement age of 65. He withdrew at age 59. Mr. Niven testified that the partners had an interest in the assets of the firm while partners. (Tr. 98.) The language of the two letters relied upon by the Government to bring taxpayer under Section 2 of Article XI plainly recognize that the parties intended that Mr. Whitworth surrender his interest in the firm in exchange for the contract payments. Hence, he must have had an interest. That interest was a capital asset. The proceeds of the sale thereof would be capital gain under Section 117 of the Internal Revenue Code. (Appendix, infra, pp. 19-20.) The letter of November 27, 1942 (Tr. 67) closed with the proviso, "It is also understood that as of May 1, 1942 you have surrendered all your interest in the firm and the firm name and assets subject only to your right to receive the payments above provided for."

Of importance to taxpayers and the Government is the gaping tax loop-hole opened by the Court of Appeals under its decision. Members of any personal service partnership are afforded the opportunity to avoid the tax effect of a purchase and sale agreement covering the interest of a withdrawn partner by masking the transaction so as to give it the effect of payments to a withdrawn partner under a mutual insurance plan. Under such a plan a withdrawn partner is alone subject to tax on ordinary income instead of taxing the continuing partners on such income earned by them and treating the payments to the withdrawn partner as capital invested by them in the interest acquired. Under this latter treatment the Government

would be entitled to a capital gains tax from the withdrawn partner, and a tax on ordinary income of the continuing partners, which is lost as revenue by virtue of the decision below. Under Proposition I, the continuing partners escape tax on income earned by them which was assigned to Whitworth.

IN CONCLUSION

The principle of income taxation, long established by this Court, that income cannot be disassociated from the source which created it, should be reaffirmed in *Whitworth,* to correct the serious departure therefrom by the Court below.

It is extremely important to all practitioners of the professions, a wide public interest, that there be no prostitution of the doctrine of *Bull* v. *United States,* buttressed with the "mutual insurance" rationale represented by *Coates,* and *Sidney Hess, supra; Courtland N. Smith,* a Tax Court memorandum opinion, CCH, Dec. 17,989 (M), 9 TCM 1084 (1950). Here there was an agreement between Whitworth and the other partners of Touche, Niven & Co., independent of the Partnership Agreement that embraced a "mutual insurance" plan inapplicable to him. The *real transaction,* under the principles of *Bull,* amounted to the purchase and sale of Whitworth's interest in the firm for a fixed sum of $60,000, payable to him without regard to future firm profits, for the capital interest he surrendered and left in the firm. The proceeds, if taxable at all, should be treated as capital gain.

This petition for a writ of certiorari should be granted.

Respectfully submitted,

SPAULDING GLASS,
135 South LaSalle Street,
Chicago 3, Illinois,
Attorney for Petitioners.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) Exclusions From Gross Income.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(3) Gifts, bequests, devises and inheritances.—The value of property acquired by gift, bequest, devise or inheritance. * * *

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(13) *Partnerships.*—If the property was acquired, after February 28, 1913, by a partnership

and the basis is not otherwise determined under any other paragraph of this subsection, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. If the property was distributed in kind by a partnership to any partner, the basis of such property in the hands of the partner shall be such part of the basis in his hands of his partnership interest as is properly allocable to such property.

* * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [As amended by Section 115(b), Revenue Act of 1941, c. 412, 55 Stat. 687, and Section 151(a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdi-

vision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer.

* * * * *

(4) [As amended by Section 150(a), Revenue Act of 1942, *supra*] *Long-Term Capital Gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

(b) [As amended by Section 150(c), Revenue Act of 1942, *supra*] *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

* * * * *

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) [As amended by Section 150(g), Revenue Act of 1942, *supra*] As part of his gains and losses from sales or exchanges of capital assets held for not more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than 6 months.

(b) [As amended by Section 150(g), Revenue Act of 1942, *supra*] As part of his gains and losses from sales or exchanges of capital assets held for more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

(a) [As amended by Section 9(c), Individual Income Tax Act of 1944, c. 210, 58 Stat. 231] *General Rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b), (c), and (d).

(b) [As amended by Section 150(g), Revenue Act of 1942, *supra*] *Segregation of Items.*—

(1) *Capital Gains and Losses.*—There shall be segregated the gains and losses from sales or exchanges of capital assets.

(2) *Ordinary Net Income or Loss.*—After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

(c) *Charitable Contributions.*—In computing the net income of the partnership the so-called "charitable contribution" deduction allowed by section 23(o) shall not be allowed; but each partner shall be considered as having made payment, within his taxable year, of his distributive portion of any contribution or gift, payment of which was made by the partnership within its taxable year, of the character which would be allowed to the partnership as a deduction under such section if this subsection had not been enacted.

(d) [As added by Section 9(c), Individual Income Tax Act of 1944, *supra*] *Standard Deduction.*—In computing the net income of the partnership, the standard deduction provided in section 23(aa) shall not be allowed.

SEC. 184 [As amended by Section 126(f), Revenue Act of 1942, *supra*]. CREDITS AGAINST NET INCOME.

The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts (not in excess

of the net income of the partnership) of interest specified in section 25(a) as are received by the partnership. If the partnership elects under section 125 to treat the premium on bonds, the interest on which is allowable as a credit under section 25(a)(1) or (2), as amortizable, for the purposes of the preceding sentence the partner's proportionate share of the interest received by the partnership shall be his proportionate share of such interest (determined without regard to this sentence) reduced by so much of the deduction under section 23(v) as is attributable to such share.

SEC. 186. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of the member of a partnership to the extent provided in section 131.

SEC. 187. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

SEC. 188. DIFFERENT TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership, in computing the net income of the partner for his taxable year, shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the partner.

SEC. 189 [As added by Section 211(d), Revenue Act of 1939, c. 247, 53 Stat. 862]. NET OPERATING LOSSES.

The benefit of the deduction for net operating losses allowed by section 23(s) shall not be allowed to a partnership but shall be allowed to the members of the partnership under regulations prescribed by the Commissioner with the approval of the Secretary.

SEC. 190 [As added by Section 155(h), Revenue Act of 1942, *supra*]. ALLOWANCE OF AMORTIZATION DEDUCTION.

In the case of emergency facilities of a partnership, the benefit of the deduction for amortization allowed by section 23(t) shall not be allowed to the members of a partnership but shall be allowed to the partnership in the same manner and to the same extent as in the case of an individual.

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise

distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	3
Argument	8
Conclusion	13

CITATIONS

Cases:

Barth v. *Commissioner*, 35 B.T.A. 546	11
Bull v. *United States*, 295 U.S. 247	10
Coates v. *Commissioner*, 7 T.C. 125	11
Collins v. *Commissioner*, 14 T.C. 301	11
Commissioner v. *Jacobson*, 336 U.S. 28	12
Edwards v. *Commissioner*, 102 F. 2d 757	11
General Utilities Co. v. *Helvering*, 296 U.S. 200	11
Gudeon v. *Commissioner*, 32 B.T.A. 100	11
Hallowell v. *Commissioner*, 39 B.T.A. 50	11
Helvering v. *Minnesota Tea Co.*, 296 U.S. 378	11
Helvering v. *Tex-Penn Oil Co.*, 300 U.S. 481	11
Hess v. *Commissioner*, 12 T.C. 773	11
Krusen v. *Commissioner*, 148 F. 2d 210, affirming decision of August 31, 1944	11
McAfee v. *Commissioner*, 9 T.C. 720	11
Madden v. *Commissioner*, decided July 2, 1946	11
Noel v. *Parrott*, 15 F. 2d 669, certiorari denied, 273 U.S. 754	12
Old Colony Tr. Co. v. *Commissioner*, 279 U.S. 716	12
Proctor v. *Commissioner*, 39 B.T.A. 67	11
Remington v. *Commissioner*, 9 T.C. 99	11
Robertson v. *United States*, 343 U.S. 711	12
Smith v. *Commissioner*, decided November 29, 1950	11
Wilkins v. *Commissioner*, 161 F. 2d 830, affirming 7 T.C. 519	11

Statute:

Internal Revenue Code:	
Sec. 22 (26 U.S.C. Sec. 22)	2, 12
Sec. 117 (26 U.S.C. Sec. 117)	10

In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 314

CHARLES R. WHITWORTH AND ESTATE OF SARAH M. WHITWORTH, CHARLES R. WHITWORTH, EXECUTOR, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 121-133) are not officially reported. The opinion of the Court of Appeals (R. 140-146) is reported at 204 F. 2d 779.

JURISDICTION

The judgment of the Court of Appeals was entered on June 12, 1953. (R. 147.) The petition for a writ of certiorari was filed on September 4, 1953.

The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

The taxpayer, a former member of a partnership engaged in the business of public accounting, retired from the firm pursuant to an agreement which entitled him to certain payments for a period of five years out of the profits, if any, of the continuing partnership.

The question is whether these payments are taxable as ordinary income, as the Tax Court and the Court of Appeals held, or are taxable as capital gain, as the taxpayer contends.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * * *
>
> (26 U.S.C. 22.)

STATEMENT

The material facts, as found by the Tax Court, may be summarized as follows:

The taxpayer became a partner in 1919 in the firm of Touche, Niven & Company. The firm was engaged in the business of acting as public accountants and auditors. The taxpayer made a capital contribution of $12,500 at the time he became a partner. (R. 122.)

A new partnership agreement was signed in 1936 by seventeen partners. Of these, five were designated as administrative partners who were to manage and control the business and affairs of the partnership. The taxpayer was one of the administrative partners. (R. 122.)

The partnership agreement (Ex. B-2, R. 36-62) provided in Article IV (R. 40, 123), that the firm name of Touche, Niven & Company should belong to the firm and should not be disposed of so long as the partnership continued its existence; it also provided that a deceased, retiring or withdrawing partner "shall have no interest in the firm name and shall have no right to receive any payment therefor." The death, retirement or withdrawal of any partner was not to dissolve the partnership between the remaining partners and the interest of such deceased, retiring or withdrawing partner in the firm's assets and business was to become vested in the continuing partners; the deceased, retiring or withdrawing partner was to have no further interest in the firm's assets or business, except the right to receive certain payments provided for in Article

XI of the partnership agreement. (Art. X, Secs. 1 and 6, R. 45-47, 124-125.)

A retiring or withdrawing partner, or the estate of a deceased partner, was entitled to receive immediately any loan made by the partner to the firm and any balance in his current account adjusted to the time of his death, withdrawal or retirement. (Art. XI, Sec. 1 (a), R. 47, 125-126.) He was also entitled to receive his portion of the distributable profits from the beginning of the current fiscal year to the date of death, retirement or withdrawal. This amount was payable during the ensuing fiscal year. (Art. XI, Sec. 1 (b), R. 47, 126.) He was also entitled to receive a return of his paid-up participation in the stated capital of the firm, this sum being payable in six semi-annual installments, with the unpaid balance bearing interest at the rate of five percent per year. (Art. XI, Sec. 1 (c), R. 47-48, 126.)

Article XI, Section 2, provided for additional payments in the case of a partner who retired from the firm after reaching the age of 65 or who died at any age. These payments, which were to be made out of the "distributable profits" of the firm, were to be in such amounts as might be determined by the administrative partners, but not less than the smaller of the following amounts (Art. XI, Sec. 2, R. 48-49):

> (a) an amount equal to the sum of the salary plus the distributable profits of the partnership which such deceased or retiring partner received or was entitled to receive in respect

of the business of the partnership carried on during the three (3) fiscal years of the partnership next preceding the fiscal year in which such partner died or retired; or

(b) an amount equal to the sum of the salary plus the distributable profits of the partnership to which such deceased or retiring partner would have been entitled, if he had not died or retired and if his ratio in the profits of the partnership had not been altered, in respect of the business of the partnership carried on during the three (3) succeeding fiscal years of the partnership, including the fiscal year in which such partner died or retired, but for the purposes of this subdivision (b) the distributable profits shall be determined after deducting current salaries and current interest on capital of any additional partners as well as those of the surviving or continuing partners.

The amount was to be paid in six equal, annual installments and, unless there were not sufficient profits of the continuing firm, the annual installments were not to be less than fifty percent of the annual salary of the former partner or less than $5,000 per year. (R. 49, 127.)

Article XI, Section 2, specifically provided that (R. 49, 127):

> The payment under this Section 2 is intended as a distribution of income to the retiring partner or the estate of a deceased partner for a limited period subsequent to his retirement or death.

Article XI, Section 3 (R. 50, 128), provided that a majority in interest of the administrative partners could pay such sum of money in such installments as they might deem advisable to any partner who retired before reaching the age of 65 or who withdrew for any other reason.

The taxpayer wrote a letter (Ex. C-3, R. 63-64, 128-129) to the firm in October, 1939, reiterating his previously expressed desire to retire from the partnership when he reached the age of 60, on October 12, 1943, and stating his understanding that it was agreeable to the firm that, even though he would retire prior to reaching 65, nevertheless (R. 129): "the provisions of Section 2 of Article XI of the partnership agreement shall be applicable * * *." He requested that the firm note its acceptance of his letter as an agreement that, among other things (R. 129) "the provisions of Section 2 of Article XI shall be applicable to my retirement" and that the payments under Section 2 of Article XI should be accelerated so as to be made in five rather than six years. The firm noted acceptance of the terms of the letter.

Pursuant to this agreement, the taxpayer retired from the partnership on April 30, 1942, to accept a commission with the United States Army. He was then 59 years of age. On November 27, 1942, the firm wrote to the taxpayer (Ex. E-5, R. 66-68, 130-131) "to incorporate our agreement in a letter signed by the firm and approved by you." The letter stated that for the fiscal years ending on September 30, 1942, and September 30, 1943, the tax-

payer was to receive an amount equal to his salary and interest in the distributable profits of the firm "the same as though you had remained a member of the firm," except that, as they had agreed, the average for the four years ending September 30, 1943, should not exceed $20,000 per year. The letter also stated (R. 67, 130-131):

> 2. Notwithstanding the fact that you have not and will not have attained the age of sixty-five years on September 30, 1943, you shall be entitled to receive the retirement payments provided for in Section 2 of Article XI of the Partnership Agreement which shall be computed and be payable as if you had retired on September 30, 1943 except that, upon your request, we will accelerate the payments provided under Section 2 of Article XI so that the said payments shall be made in five instead of six years.
>
> 3. You shall be entitled to receive the payments provided for in Section 1 of Article XI of the Partnership Agreement but, notwithstanding your retirement as of May 1, 1942, said payments shall be determined and be payable as if you had retired on September 30, 1943.

The taxpayer signified his approval of this arrangement by an endorsement of the letter. (R. 68, 131.) Pursuant to the agreement, the taxpayer received $20,405.17 in 1942, and $20,000 in 1943, as his salary and share of distributable profits. He also received $12,500 on account of the credit balance in his capital account and $3,978.36 as his

share of the cash surrender value of a life insurance policy on the life of John B. Niven, the premiums on which had been charged to all the partners. In addition, the taxpayer received $12,000 in each of the years 1944-1948, inclusive, pursuant to the agreement under which he had retired from the firm. (R. 131.)

The Tax Court held that the $12,000 payments received by the taxpayer in each of the taxable years 1945 and 1947 constituted ordinary income and were not, contrary to taxpayer, taxable as capital gain from the sale of his partnership interest. (R. 133.) The Court of Appeals affirmed. (R. 140-146.)

ARGUMENT

1. The taxpayer, upon retirement as a partner from a large accounting firm, was repaid his original capital contribution. In addition, by agreement, as a retired partner he became entitled to receive certain payments from the partnership during a five year period. The amount of the retirement payments was determined by the extent to which he had been entitled to participate in the firm's profits during the three year period preceding his retirement and they were to be made only out of the profits of the firm, if any. The Tax Court and the Court of Appeals held that these retirement payments, totaling $60,000 during the five year period, were taxable as ordinary income and rejected the taxpayer's contention that the payments represent the proceeds from the sale of his partnership

interest and that they were taxable as capital gain. The decisions of the courts below are demonstrably correct.

Under the express terms of the partnership agreement, the taxpayer, upon withdrawing from the firm, was entitled to the return of his capital investment, and to receive his share of current profits up to the date of retirement, and to nothing else. He had, as a party to the articles of partnership, agreed in advance that the partnership would not be dissolved on his retirement, that the firm name would belong to the continuing partners, and that they should be entitled to retain all the firm's assets and would be empowered to continue the firm's business. He had agreed that, if he should retire, he would possess no further interest in the assets or business of the firm and would only be entitled to the particular payments specified in the agreement. (Ex. B-2, Arts. IV and X, R. 40, 45-47.) And, since the taxpayer chose to retire prior to reaching the age of 65, he was, except for the repayment of his capital investment and for the payment of his share of current earnings (Ex. B-2, Art. XI, Sec. 1, R. 47-48), entitled to receive nothing from the continuing partners under the precise terms of the partnership agreement. Since the taxpayer had nothing of value to sell, the subsequent agreement permitting him to receive retirement payments (notwithstanding that he was not entitled to those payments under the precise terms of the partnership agreement) did not and could not represent a sale of a capital asset

to the continuing partners. *Bull* v. *United States*, 295 U.S. 247, 254. The Court of Appeals, accordingly, correctly concluded that (R. 146):

> The fact that taxpayer received from the firm more than he had a right to demand is no indication that the sums received were in payment for any interest in the firm or that they became upon receipt an enhancement in his capital assets as distinguished from income. * * *

The taxpayer's argument (Pet. 13-17) that the payments were made to acquire his interest in the firm necessarily ignores the terms of the partnership agreement which, as has been shown, demonstrates that a withdrawing or retiring partner had no interest beyond his capital contribution. It also ignores the testimony of all the witnesses which was to the effect that the retirement payments under the partnership agreement were not intended as the purchase price of the withdrawing partner's interest. (R. 74-76, 78, 79, 106, 109-110, 112-113.) There is no contrary evidence. The taxpayer's suggestion that, unless a partnership interest were sold, there would have been no consideration for the payments to him (Pet. 15-17) may prove that the partnership was under no obligation to make the payments, but it does not at all establish that the payments which he did in fact receive were the proceeds from the sale of a capital asset taxable at preferential rates under Code Section 117.[1]

---

[1] While the factual situation necessarily varies from case to case, the decision in the present case is in harmony with

2. The taxpayer also contends that the payments are not taxable at all because they constituted gifts which are exempt from tax under Code Section 22 (b)(3). (Pet. 8-13.) This argument is a distinct afterthought for no such claim for exemption was made in the court below or even alluded to in the three separate briefs filed by the taxpayer, nor was such an argument made in the Tax Court. On the contrary, until the filing of the petition for a writ of certiorari, the taxpayer's position has always been that the income in question was capital gain because it had been received as consideration for the sale of his partnership interest, a position completely inconsistent with the notion that a gift was received. Plainly, the contention that a gift was received cannot be raised for the first time in this Court. *Helvering* v. *Minnesota Tea Co.*, 296 U.S. 378, 380; *Helvering v. Tex-Penn Oil Co.*, 300 U.S. 481, 498; *General Utilities Co.* v. *Helvering*, 296 U.S. 200, 206.

At all events, the argument is devoid of merit for

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numerous Tax Court decisions. See *Collins* v. *Commissioner*, 14 T.C. 301; *Hess* v. *Commissioner*, 12 T.C. 773; *McAfee* v. *Commissioner*, 9 T.C. 720; *Remington* v. *Commissioner*, 9 T.C. 99; *Coates* v. *Commissioner*, 7 T.C. 125; *Hallowell* v. *Commissioner*, 39 B.T.A. 50; *Proctor* v. *Commissioner*, 39 B.T.A. 67; *Barth* v. *Commissioner*, 35 B.T.A. 546; *Gudeon* v. *Commissioner*, 32 B.T.A. 100; *Smith* v. *Commissioner*, decided November 29, 1950 (1950 P-H T.C. Memorandum Decisions, par. 50,286); *Madden* v. *Commissioner*, decided July 2, 1946 (1946 P-H T.C. Memorandum Decisions, par. 46,158). See also *Wilkins* v. *Commissioner*, 161 F. 2d 830 (C.A. 1st), affirming 7 T.C. 519; *Edwards* v. *Commissioner*, 102 F. 2d 757 (C.A. 10th); *Krusen* v. *Commissioner*, 148 F. 2d 210 (C.A. 3d), affirming *per curiam* the decision of the Tax Court dated August 31, 1944 (1944 P-H T.C. Memorandum Decisions, par. 44,287).

there is nothing in the record which would have supported a finding that a gift was intended, even if such a contention had been seasonably advanced in the Tax Court. The record evidence shows that the retirement payments provided for in the partnership agreement constituted a business arrangement, carefully planned by all the partners, and were intended to soften the economic hardship that might otherwise attend a partner's retirement. Nor is there any evidence to demonstrate that the provision for these similar payments to the taxpayer arose out of any different motives. In short, in this arms' length business transaction there is completely absent the donative intent which is the prerequisite of a tax exempt gift of property. *Robertson* v. *United States,* 343 U.S. 711, 713-714; *Commissioner* v. *Jacobson,* 336 U.S. 28, 51. The fact that the payments were gratuitous, in the sense that the partnership was under no legal obligation to undertake them, is quite immaterial for the same is true, for example, where a bonus or additional compensation is voluntarily paid; such payments constitute taxable income coming within the broad sweep of Code Section 22 (a), *supra,* and are not gifts. *Old Colony Tr. Co.* v. *Commissioner,* 279 U.S. 716, 731; *Noel* v. *Parrott,* 15 F. 2d 669 (C.A. 4th), certiorari denied, 273 U.S. 754.

3. Notwithstanding the taxpayer's sweeping assertion that the decision below conflicts with applicable decisions of this Court (Pet. 8), it is plain that no such conflict exists. The cases on which the taxpayer apparently relies (Pet. 8) all involve the

question whether, in a gratuitous, intra-family disposition, taxable income can be deflected from the person who earns it. These decisions have nothing to do with the issue whether taxable income is realized by the recipient of payments flowing out of an arms' length business transaction, nor do they have the slightest bearing on whether capital gain or ordinary income is realized in the circumstances here or in any other circumstances.

CONCLUSION

There is no conflict in decisions. The decision of the Court of Appeals is correct. There is no reason which would warrant further review of this case. Accordingly, the petition for a writ of certiorari should be denied.

Respectfully,

ROBERT L. STERN,
Acting Solicitor General.
H. BRIAN HOLLAND,
Assistant Attorney General.
ELLIS N. SLACK,
HILBERT P. ZARKY,
Special Assistants to the Attorney General.

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No. 314

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

CHARLES R. WHITWORTH AND
ESTATE OF SARAH M. WHITWORTH,
CHARLES R. WHITWORTH, EXECUTOR,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITIONERS' REPLY TO BRIEF FOR THE RESPONDENT IN OPPOSITION

SPAULDING GLASS,
135 South LaSalle Street,
Chicago 3, Illinois,
Attorney for Petitioners.

TWENTIETH CENTURY PRESS, INC., CHICAGO

INDEX

PAGE

Argument 1

Conclusion 4

LIST OF AUTHORITIES CITED

Carol F. Hall et al., 19 T.C. No. 57 (1952)..... 2

Harrison v. Schaffner, 312 U.S. 579..... 3

Helvering v. Clifford, 309 U.S. 331..... 3

Helvering v. Horst, 311 U.S. 112..... 3

Internal Revenue Code Section 22(b)(3)..... 4

Lucas v. Earl, 281 U.S. 111..... 3

Noel v. Parrott, 15 F.2d 669 (C.A. 4th), certiorari denied, 273 U.S. 754..... 2

Old Colony Tr. Co. v. Commissioner, 279 U.S. 716, 731.. 2

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PETITIONERS' REPLY TO BRIEF FOR THE RESPONDENT IN OPPOSITION

ARGUMENT

With the exception of section 2, beginning at page 11 of respondent's brief, respondent's statement and argument are predicated on erroneous legal conclusions included in his statement of the "Question Presented" at page 2 of his brief, to the effect that, "The taxpayer, a former member of a partnership engaged in the business of public accounting, *retired from the firm pursuant to an agreement which entitled him to certain payments for a period of five years*

out of profits, if any, of the continuing partnership." (Italics supplied to denote erroneous legal conclusions.)

The questions presented are whether there was any ordinary income taxable to petitioner arising from the payments of $12,000 each during 1945 and 1947, or whether he is to be taxed with gain from the sale of a capital asset, his partnership interest.

Respondent's statement and Section 1 of his argument ignore the finding of the Court of Appeals that the record establishes without question that the payments aggregating $60,000 were made pursuant to an agreement independent of the 1936 Partnership Agreement. (Tr. 145.) The Court of Appeals was correct, as the evidence before the Tax Court establishes beyond question that the payments to Whitworth were not made pursuant to Section 2 of Article XI of the Partnership Agreement, and this is amply demonstrated at pp. 11-13 of the petition. It is on the findings of the Tax Court to the contrary, appearing in the opinion filed in *Carol F. Hall et al.,* 19 T.C. No. 57 (1952), that the erroneous legal conclusions of the "Question Presented" are predicated.

Under Section 2 at p. 12 of his argument respondent has admitted, "(t)he fact that the payments were gratuitous, in the sense that the partnership was under no legal obligation to undertake them", but says this is immaterial for the same is true where a bonus or additional compensation is voluntarily paid, citing *Old Colony Tr. Co.* v. *Commissioner,* 279 U.S. 716, 731; *Noel* v. *Parrott,* 15 F.2d 669 (C.A. 4th), certiorari denied, 273 U.S. 754.

In both of these cases taxpayers were employees performing services for a corporation under contract, so that the "voluntary" payments to them were supported by a present and valuable consideration—their services. Peti-

tioner in the Tax Court pleaded that the payments here involved were not in consideration of services rendered by him prior to May 1, 1942, when he ceased to be a partner of said firm and ceased to perform services for said firm; were not in consideration of any services performed by him during 1945 and 1947; did not represent his distributive share of earnings of said firm for past services; but did represent the earnings of the then partners of said firm, the $12,000 in each year being their property before disbursement thereof to him. (Tr. 5 and 6). It is contended that the record clearly establishes there was no present consideration for these payments by virtue of any services performed by Mr. Whitworth, so that the foundation for the only exception taken by respondent to the fact of an admitted gift is eliminated by this distinction.

Contrary to respondent's statement, the income exclusion theory was presented on appeal from the decision of the Tax Court, and petitioners cited in their briefs the decisions of this Court, appearing in the first paragraph at page 8 of the petition. *Harrison* v. *Schaffner,* 312 U.S. 579; *Helvering* v. *Clifford,* 309 U.S. 331; *Helvering* v. *Horst,* 311 U.S. 112; *Lucas* v. *Earl,* 281 U.S. 111.

If the amounts in question, as taxable income, belonged to the continuing partners, as contended by petitioner, it follows, if there was no legal consideration therefor, that the payments to him were gratuitous in fact, as respondent has admitted. It can hardly be said that the donative intent to make a gift of this money was lacking, as a $20,000 payment made to Whitworth for the year ending September 30, 1943, also subject to the terms of the separate agreement, was characterized as a "gift" by Mr. Niven. (Tr. 99). The contract itself was a gratuitous arrangement. Nothing more than Mr. Whitworth's evident willingness to receive such payments is required to reach the conclusion that the

payments were not taxable at all because they constituted gifts which are exempt from tax under Code Section 22(b)(3). Petitioners have not shifted their contentions.

The decisions of this Court relied upon by petitioners may touch upon intra-family dispositions, (Resp. 13) but they are equally applicable to any situation in which a person or a group whose services create income attempts to be relieved from taxation by an anticipatory transfer of the right to the income to another. That is what the continuing partners of Touche, Niven & Co. sought to do in effecting an agreement with Whitworth. They alone are taxable on the amounts earned and received by the firm, of which they, and not Whitworth, were members and participants in the years 1945 and 1947.

Accordingly, the petition for a writ of certiorari should be granted.

Respectfully,

SPAULDING GLASS,
135 South LaSalle Street,
Chicago 3, Illinois,

Attorney for Petitioners.